Cytonn SSA Financial Services Research Weekly Note - 9th October 2018

Executive Summary: In this weekly research note, we highlight the performance of the listed banks in the Sub-Saharan Africa Financial Services Sector, looking at their market performance, earning results, the latest developments in the Sub Saharan Africa Banking Sector during the week, and our equities universe of coverage.

Section I: Market Performance:

During the week, the equities market recorded mixed performances with NASI and GGSECI gaining by 0.8% and 0.2%, respectively, while NGSEASI declined by 0.7%. This takes their YTD performance to 2.1%, (13.8%), and (16.0%) for the GGSECI, NASI, and NGSEASI, respectively.

Below is a summary of top gainers and losers in our universe of coverage for last week:

Summary of Top Gainers and Losers for Week Ending 5th October 2018					
Top Gainers			Top Losers		
Company	Country	Change	Company	Country	Change
Bank of Baroda	Uganda	11.1%	National Bank	Kenya	(10.3%)
HF Group	Kenya	1.7%	I&M Holdings	Kenya	(8.1%)
Equity Group	Kenya	1.3%	Stanbic IBTC Holdings	Nigeria	(7.6%)
Co-operative Bank	Kenya	1.0%	Diamond Trust Bank	Kenya	(5.2%)
Barclays Bank	Kenya	0.5%	KCB Group	Kenya	(4.3%)

Kenya

NASI gained by 0.8% last week, driven by gains in large cap stocks such as, BAT, Equity Group, Co-operative Bank, Safaricom, and Barclays Bank of Kenya that gained by 3.4%, 1.3%, 1.0%, 1.0%, and 0.5%, respectively. In our universe of coverage, HF Group, Equity Group, Co-operative Bank and Barclays gained by 1.7%, 1.3%, 1.0% and 0.5% respectively. Equities turnover decreased by 16.9% to USD 34.0 mn from USD 41.0 mn the previous week, bringing the YTD turnover to USD 1.5 bn. During the week, foreign investors remained net sellers with the net outflow decreasing by 33.2% to USD 8.0 mn, from USD 12.1 mn the previous week. We expect the market to remain subdued in the near term as foreign investors exit the broader emerging markets due to the rising interest rates in the US coupled with the strengthening of the US Dollar.

Nigeria

The Nigerian All Share index lost 0.7% during the week, largely driven by declines in the materials and financial services sectors (having a combined average weighting of 65.1%), by 1.4% and 2.2%, respectively. For our financial services universe of coverage, Stanbic IBTC Holdings, UBA Bank, Ecobank Transnational, Union Bank, and Access Bank declined by 7.6%, 2.4%, 2.2%, 2.0% and 1.2%, respectively. Total turnover for the week decreased by 77.3% to USD 22.0 mn from USD 39.0 mn the previous week.

Ghana

The GSE Composite Index gained by 0.2% during the week, driven by gains mainly in SIC Societe Generale Ghana Ltd and Guinness Ghana Breweries Limited, which improved by 2.0%, 0.8% respectively. In our universe of coverage for Ghana, Ecobank, CAL Bank and Stanchart, remained flat while Ghana Commercial Bank declined by 0.2%. Total turnover for the week decreased by 58.2% to USD 0.71 mn from USD 1.7 mn the previous week.

Section II: Earnings Releases:

There were no earnings released during the week.

Section III: Latest Developments in the Sub Saharan Africa Banking Sector during the week:

Kenya

I&M Bank has secured a USD 40.0 mn (Kshs 4.0 bn) loan from the FMO, a Dutch Development Bank, for onward lending to small business enterprises (SMEs), in what is expected to boost their operations, currently hampered by cautious lending towards the segment. According to FMO's Chief Investment Officer, Linda Broekhuizen, the facility will be used primarily for onward lending to SMEs, thus supporting the expansion of I&M Bank's strategy of increasing its SME loan book and boost the local economy in the process. In recent years, Kenyan banks have taken on substantial loans from international financiers, including International Finance Corporation (IFC), European Investment Bank (EIB), and the African Development Bank (AfDB). Development banks such as FMO offer attractive terms on their lending to commercial banks, including lower interest rates and longer maturity periods. Previous issues such as that of the International Finance Corporation (IFC) to Co-operative Bank have been priced at the London Interbank Offered Rate (LIBOR) of 2.8%, plus an unspecified premium, for a period of 7-years. Previously, Equity Group, Co-operative Bank, Diamond Trust Bank, Stanbic Holdings, and KCB Group have borrowed from international financiers to fund their onward lending business. The asset-liability mismatch by tenor due to the relatively long-term nature of loans and short-term nature of deposits exposes a gap that banks have chosen to fill will with credit from the international financiers.

The SMEs businesses have been hit hard following the enactment of the Banking (Amendment) Act 2015 that capped the interest chargeable on loans at 4.0% above the Central Bank Rate (CBR). Inability to price SMEs within these margins, coupled with the continually deteriorating asset quality evidenced by a rise in gross non-performing loans ratio to a weighted average of 10.0% in H1'2018 from 7.7% in H1'2017, led to a slow-down in lending to these businesses. The move by lenders has had negative effect on SMEs resulting to a slow growth in the credit extended to the private sector, of 4.3% in the last 12-months to August 2018, which remains below the Central Bank of Kenya target rate of 12.0 - 15.0%, and below the 5-year average of 13.0%.

The table below highlights several debt issues by international institutions to local banks:

Debt Issues by International Institutions to Kenyan Banks					
No.	Issuer	Bank	Issue Date	Loan Amount (Kshs bn)	Term of Credit
1.	Africa Development Bank	Kenya Commercial Bank	Oct-17	10.4	Not specified
2.	IFC	I&M Holdings	Jan-18	1.0	Not specified
3.	IFC	Cooperative Bank	Feb-18	15.2	7-years
4.	Africa Development Bank	Diamond Trust bank	Mar-18	7.5	7-years
5.	SwedFund	Victoria Commercial Bank	Apr-18	0.5	Not specified
6.	14 financial Institutions (syndicated)	Stanbic Bank	May-18	10.0	2,3 years
7.	FMO	I&M Holdings	Oct-18	4.0	Not Specified
	Total			**48.6**	

ARM's creditors, including banks like Stanbic Holdings and Africa Finance Corporation, that placed it under administration, met to vote on how to settle the company's debt. United Bank for Africa (UBA) had provided the company with a short-term loan of Kshs 500.0 mn and appointed Price Waterhouse Coopers (PwC) as administrators in an effort to recover the debt. The administrators asked the company's bankers and suppliers to file claims ahead of the meeting, where creditors owed an aggregate of 75.0% of the liabilities can decide on a solution that is binding to all. Africa Finance Corporation (AFC) provided ARM with a loan of Kshs 4.6 bn, while Stanbic Bank had provided the company with Kshs 3.2 bn, thereby holding nearly 36.0% of the total outstanding liability of Kshs 21.7 bn, and will have a major influence in the meeting. According to Pradeep Paunrana, the founding shareholder, the company is either considering liquidation, or other solutions to get the company back on its feet, which include; raising Kshs 5.0 bn through debt, or selling more of its assets, including the Tanzania operations. It is highly likely that ARM's 91.0% (30.3% annualised) decline in share price to Kshs 5.5 per share in October 2018 from Kshs 58.0 per share in August 2015, could complicate the company's plan to raise Kshs 5.0 bn through a rights issue as existing shareholders have already lost 90.0% of their paper value. We further expect that the suspension from the NSE bourse will continue beyond October 26th as PwC and creditors work to decide on the best solution. In our view, ARM should sell off the operations in Tanzania, a move that will see it reduce the debt but leave it with a smaller and potentially profitable business.

Central Bank of Kenya (CBK) and the Kenya Deposit Insurance Corporation (KDIC) announced they had received an improved binding offer from KCB Group, inching closer to closing a deal that will see the bank acquire certain assets and liabilities from Imperial Bank. CBK and KDIC will hold a meeting with depositors of Imperial Bank, which is under receivership as they finalize assessment of the revised offer from KCB. At the end of June 2015, Imperial Bank held Kshs 58.0 bn in customer deposits and was classified a mid-tier lender with operations in Kenya and Tanzania. The actions by CBK and KDIC are a step in the right direction, and if successful, will be the second instance a bank is successfully brought out of receivership after Chase Bank was bought by SBM Kenya Limited. We note that the CBK and KDIC need to expedite the process, given that the CBK is behind its earlier schedule of having a successful bidder by February 2018. If successful, depositors will be able to access deposits locked in the lender since 2015.

Nigeria

The 12 banks listed on the Nigerian Stock Exchange (NSE) recorded marginal growth in interest income to NGN 920.4 bn from NGN 920.2 bn in H1'17. The banks have, however, reduced their non-performing loans (NPLs) by 26.1 % to NGN 263.0 bn in H1'18 from NGN 356.0 bn in H1'17, indicating an improvement in asset quality in the banking sector. The tier-1 banks held a significant portion of the NPLs with NGN 175.4 bn, representing 66.7% of the total NPLs. In absolute terms, the banks with the largest share of bad debts are:

1. First Bank - NGN 149.6 bn;
2. Ecobank Group - NGN 41.1 bn;
3. Diamond Bank - NGN 18.4 bn;
4. Zenith Bank NGN - 9.7 bn and
5. Wema Bank NGN - 8.7 bn.

First City Monument Bank (FCMB) led in the rationalization of asset quality, with its NPLs declining by 26.5 % to NGN 7.3 bn from NGN 10.0 bn, followed by First Bank who's NPLs dropped by 8.8% to NGN 149.6 bn from NGN 164.1 bn. Diamond Bank's NPLs dropped by 2.9% to NGN 18.4 bn from NGN 18.9 bn. The implication of the reduction of impairment in H1'2018 shows the extent to which the banks have gone in cleaning their loan books and the reduced lending activity indicated by the marginal increase in the net interest income, which negatively affects economic growth in Nigeria. Generally, the performance of these banks showed that they concentrated more in Treasury Bills and Federal Government Bonds rather than lending which is the core business of banking.

Ghana

The Bank of Ghana (BOG) has written off Non Performing Loans (NPLs) amounting to GHC 1.2 bn on the books of banks in the country. The write-off means that the Central bank will consider the amount irretrievable from customers. As at August 2018, the non-performing loans was at 23.3% compared to 21.9% as at August 2017, indicating a deterioration of asset quality on year to year basis. The move was necessary to reduce the high levels of non-performing loans in the Country and clean the financial system to make it robust. The Ghana banking industry remains stable despite pockets of weaknesses. On the supervision front, Bank of Ghana continues to put in extra measures to address weaknesses in the banking sector. These included the issuance of the Capital Requirements Directive towards the implementation of Basel II/III in the banking sector, as well as Financial Holding Company's Directive (a directive to facilitate understanding of the requirements for the adoption and operations of a financial holding company in Ghana) to address corporate governance issues currently facing the banking system. The outlook for the industry remains positive in the short to medium-term as measures being introduced will address weaknesses within the banking system.

Section IV: Equities Universe of Coverage:

The week-on-week performance, valuation and expected return of the companies in our SSA universe of coverage is highlighted in the table below:

Equities Universe of Coverage:									
Banks	**Price as at 28/09/2018**	**Price as at 5/10/2018**	**w/w change**	**YTD Change**	**LTM Change**	**Target Price***	**Dividend Yield**	**Upside/Downside****	**P/TBv Multiple**
NIC Bank***	25.3	24.5	(3.0%)	(27.4%)	(29.1%)	48.8	4.1%	103.3%	**0.7x**
Diamond Trust Bank***	174.0	165.0	(5.2%)	(14.1%)	(11.3%)	283.7	1.6%	73.5%	**1.0x**
Zenith Bank***	21.5	21.6	0.2%	(16.0%)	(12.7%)	33.3	12.5%	67.1%	**1.0x**
KCB Group***	40.5	38.8	(4.3%)	(9.4%)	(3.7%)	61.3	7.7%	65.9%	**1.3x**
Union Bank Plc	5.1	5.0	(2.0%)	(35.9%)	(16.5%)	8.2	0.0%	63.0%	**0.5x**
I&M Holdings***	99.0	91.0	(8.1%)	(9.0%)	(27.8%)	138.6	3.8%	56.2%	**1.0x**
Ghana Commercial Bank***	5.4	5.3	(0.2%)	5.7%	33.5%	7.7	7.1%	51.7%	**1.3x**
Equity Group	40.0	40.5	1.3%	1.9%	9.5%	56.2	4.9%	43.7%	**1.9x**
UBA Bank	8.4	8.2	(2.4%)	(20.4%)	(10.9%)	10.7	10.4%	40.9%	**0.6x**
Co-operative Bank	15.2	15.4	1.0%	(4.1%)	(7.8%)	19.9	5.2%	34.9%	**1.3x**
CRDB	160.0	160.0	0.0%	0.0%	(8.6%)	207.7	0.0%	29.8%	**0.5x**
Ecobank	8.0	8.5	5.6%	11.2%	31.1%	10.7	0.0%	27.0%	**1.8x**
Barclays	10.6	10.7	0.5%	10.9%	4.4%	12.5	9.4%	26.8%	**1.4x**
Access Bank	8.2	8.1	(1.2%)	(23.0%)	(17.9%)	9.5	5.0%	23.0%	**0.5x**
CAL Bank	1.2	1.2	0.0%	8.3%	32.4%	1.4	0.0%	19.7%	**1.0x**
HF Group***	5.8	5.9	1.7%	(43.3%)	(38.8%)	6.6	5.9%	17.8%	**0.2x**
Stanbic Bank Uganda	33.0	33.0	0.0%	21.1%	21.1%	36.3	3.5%	13.5%	**2.3x**
Standard Chartered	192.0	190.0	(1.0%)	(8.7%)	(15.9%)	196.3	6.6%	9.9%	**1.5x**
Guaranty Trust Bank	36.4	36.4	0.0%	(10.8%)	(9.7%)	37.1	6.6%	8.7%	**2.3x**
Bank of Kigali	289.0	289.0	0.0%	(3.7%)	3.6%	299.9	4.8%	8.6%	**1.6x**
SBM Holdings	6.5	6.3	(2.8%)	(15.7%)	(18.6%)	6.6	4.7%	8.5%	**0.9x**
Stanbic Holdings	90.0	90.0	0.0%	11.1%	14.6%	92.6	2.5%	5.4%	**0.9x**
Bank of Baroda	126.0	140.0	11.1%	23.9%	27.3%	130.6	1.8%	(4.9%)	**1.1x**
National Bank	5.8	5.2	(10.3%)	(44.4%)	(45.3%)	4.9	0.0%	(5.8%)	**0.4x**
Stanbic IBTC Holdings	46.0	42.5	(7.6%)	2.4%	3.7%	37.0	1.4%	(11.5%)	**2.4x**
FBN Holdings	8.9	8.9	0.0%	1.1%	56.1%	6.6	2.8%	(22.7%)	**0.5x**
Standard Chartered	26.1	26.1	0.0%	3.4%	52.3%	19.5	0.0%	(25.4%)	**3.3x**
Ecobank Transnational	17.9	17.5	(2.2%)	2.9%	4.5%	9.3	0.0%	(47.0%)	**0.6x**

**Target Price as per Cytonn Analyst estimates*
***Upside / (Downside) is adjusted for Dividend Yield*

****Banks in which Cytonn and/or its affiliates holds a stake. For full disclosure, Cytonn and/or its affiliates holds a significant stake in NIC Bank, ranking as the argest shareholder*
***** Stock prices are in respective country currency*

We are "NEUTRAL" on equities since the markets are currently trading below their historical averages. Pockets of value exist, with a number of undervalued sectors like Financial Services, which provide an attractive entry point for long-term investors, and with expectations of higher corporate earnings this year, we are "POSITIVE" for investors with a long-term investment horizon.